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Some Corporations that Own Farm and Ranch Land in South Dakota

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SOME CORPORATIONS THAT OWN FARM AND RANCH LAND IN SOUTH DAKOTA

Report of a
brief survey of some out-of-state corporations
and some in-state
corporations

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SOME CORPORATIONS THAT OWN

FARM AND RANCH LAND

IN SOUTH DAKOTA

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Russell L. Berry*

Introduction

Concern has developed about large out-of-state corporations that own agricultural land in South Dakota. Fears that such corporations may destroy family farms are often expressed. As a result legislation has been proposed which would prohibit such corporations from farming unless 51 percent of stock is owned by South Dakotans.

Do present out-of-state corporations justify such fears? A survey recently made indicates that most out-of-state corporations lease their land to independent farmers. Those few that directly manage their land are not much if any different from the home-grown kind. Most appear to be held and operated by families.

The survey was made by sending a questionnaire to 47 corporations with out-of-state addresses that owned agricultural land in South Dakota. The names were secured from county assessors and county ASCS offices by

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the South Dakota Farmers Union and made available for this study. Twenty-five questionnaires (53 percent) were returned. Of these, 17 respondents said they leased the land to independent farmers. Only five said that they were directly managing or operating their lands. These facts are perhaps the most important found in this study. The same questionnaire was sent to 35 farms and ranches incorporated in South Dakota that were authorized to issue $500,000 or more of capital stock. This list was obtained from records of the Secretary of State at Pierre, South Dakota. Because any corporation with more than $100,000 of capital assets must be authorized to issue $500,000 of capital stock, this is indeed a crude measure of size but was the only one available.

Sixteen of the in-state questionnaires (46 percent) were returned. Of these, 10 said they were engaged directly in farm or ranch operations, two said they were not active and four said they were not farm or ranch corporations.

To summarize, 82 questionnaires were mailed to firms and 41 were returned. Only 15 of the firms responding reported that they were directly managing or operating farms or ranches. Another 17 said that they were leasing land to independent farmers or ranchers. These 17 were firms with out-of-state addresses although three had been incorporated under South Dakota laws.

Some Highlights of 15 Farm Corporations

Here are the main characteristics of the 15 corporations that were engaged in farming or ranching -- not leasing the land to others:

* Most are cow-calf operations. Two included horse enterprises. Some do limited cattle feeding. Wheat production is the main crop on two farms and an important enterprise on several others.

* They operate 13,000 acres as an average. They own about 11,000 acres and rent (lease) 2,000 acres from others.

* As an average they had 4.5 stockholders -- the number ranged from 2 to 10. In 13 of the 15 firms, all the stockholders were related.

* These firms were all quite young, Only two had been organized prior to 1960. Five were organized after 1965.

* Probably none had yet lost the founder of the firm. Hence, experience with second generation problems was largely lacking.

* Eight said they were taxed as corporations and seven personally as in a partnership, as permitted by Subchapter S, Internal Revenue Code.

* In all but two corporations the manager was a stockholder and in all but five the manager was related to one or more board members.

* Counting the operator, most were four-man farms and ranches. As an average they used 51 man-months of labor. Six used less than 36 months labor, ten used less than 66 months, and four more than 66 months. This includes labor of manager, unpaid family members, and hired labor. Top labor user was a cattle feeder with 104 months of labor.

Most used two or three hired men. As an average they hired 32 months of labor per year. The balance was made up of unpaid family labor and the manager's labor. Some may have considered the manager a hired man and hence listed his labor twice. If this was done in all cases the farms would really be three-man farms rather than four.

Some Questions Answered

Five questions were asked of the incorporators. These questions and some of their answers follow:

1. "Some people say that corporations can raise capital more

easily and cheaply than can farmers who are not incorporated. What has been your experience?"

Almost all seemed doubtful that incorporation had made it easier to raise capital. Two mentioned that it would be easier if management improved. However, they did not argue that incorporation of itself would improve management. One felt that credit might be easier because the corporation helped keep land, machinery and livestock together. Another mentioned that "a corporation does not die. This should be of interest to the banker." Another said, "I cannot see any difference. But property for security is probably more easily defined and separated from personal property."

A banker personally interviewed was pessimistic. "We look at a farm or ranch corporation the same way we look at a small private or family corporation on Main Street. We look to see who and what is behind the corporation." Only large public corporations have any advantage in borrowing money, he believes.

2. "Some people say that a corporation can efficiently manage much more land and livestock than can an independent farmer or rancher. What has been your experience?"

Those replying were evenly split on this question. Eight said there was "no advantage," "depends on personnel," "might be possible," "cannot say," "both the same," "incorporation doesn't make any difference," and "would depend entirely upon the operator."

The other seven thought that incorporation might have some advantages. Said one, "each man can specialize" if two or more are involved. If incorporation keeps land together then, said a second, "larger machinery, advanced technology in farming and livestock feeding can reduce the cost-price squeeze." By incorporating, said a third, "we have gained in volume and efficiency." "High costs can be spread over more acres." Finally, "it takes more time to manage two small units of cattle and feedlots than one larger one. Two men can work together and save on all cost items and have better records."

Just why corporations make these management problems easier was not clear.

3. "Some people say that a non-farm corporation can profitably reduce their income taxes by the purchase of farms or ranches which lose money because of heavy investments in improvements. What has been your experience?"

"We have had no experience with non-farm corporations," replied one incorporator. He might well have spoken for all 15 of those replying. All said they had no non-farm business except one who was doing a little investment work.

Thus to the question "what has been your experience?" several wrote "none" or its equivalent. But one said, "The possibility is there through capital gains allowance. But generally the corporation has the same problems and possibilities as an individual." Another said "it may be true if a non-farm corporation has excess profits from other enterprises." Still another thought this possibility was not very attractive. "Possibly corporations are investing as a hedge against inflation." A professional farm manager for a bank that was in charge of a corporate farm had this to say, "The corporation is in debt and would be put out of business if too much money was lost."

4. "Some people say that the main advantage of incorporating a farm is that it helps keep the farm in the family by making estate planning easier. How do you feel about this?"

Of 15 incorporators, 14 said this was true in some degree. One said, "I believe this is true. But after a generation, estate planning may become more complicated." A second said, "This is correct. It also assures your farm managers that their jobs do not depend on the life of the owner."

A third said, "more time is needed to test this." Since only two of these firms have been incorporated for 10 years or more there is merit to this observation. Probably most were expressing a hope rather than an experience. Three mentioned the ease of transfer of stock as an important advantage of the corporation.

5. "Under what conditions would you urge a friend to incorporate his farm or ranch?"

Most of the persons replying were enthusiastic about the possibility of incorporation -- especially if families of two or more persons were involved. Fathers with two or more children and especially sons, were popular examples. Of the 15 replies, 12 gave positive replies with or without qualifications. One stressed that "the family relationship must be sound in order for the corporation to function properly." Another said, "I recommend incorporation for any business, agricultural or otherwise, that has a capital structure of $100,000 or more." Of the three negatives one said "we do not try to give people advice." Another said, "none," and the third made no response. Again in evaluating these answers it should be kept in mind that these corporations are all very young -- 12 having been organized since 1960.

Highlights of Landlord Corporations in South Dakota

As noted 25 corporations with out-of-state addresses responded. Of these, 17 said that they were leasing their land to farmers and therefore were not farming or ranching. However, their experience may help to make clear the wide range of differences that exist among corporations owning agricultural land.

Two large "public" corporations each with over 30 stockholders are of interest. One owns 1,100 acres that it leases to one or more farmers. This land "was acquired for ultimate use as a building location. However, the land will not now be used that way."

The second has 30,000 acres leased to farmers and ranchers on three-year cash leases. The manager reports "this seems to be very satisfactory to all the renters as the turnover has been very small." The land was acquired during the 1930's to protect water rights needed for their operations.

Leaving aside the two public corporations, a private college, a mission, two banks and an Illinois firm that did not report, eight of the remaining 10 firms were family owned. None had more than 10 stockholders and only two of the companies reported having an unrelated person among the stockholders.

The land holdings of most of these 17 corporations were rather small. Leaving out the 30,000 acres of the public corporation, the average for the remainder was 3,330 acres. Two were under 500 acres; seven under 1000 acres; and nine under 2000 acres. In contrast, the 15 operating corporations averaged 13,000 acres each.

Farmers who lease land from corporations generally have much more freedom and independence than do hired managers. As previously noted, 17 of the 25 out-of-state corporations were leasing their land to independent farmers. This fact may explain why only two of the 17 firms had elected to be taxed as individuals in a partnership (Subchapter S) rather than as a corporation. While most met one requirement -- less than 10 stockholders -- they probably cannot meet another -- not more than 20 percent of their income may be from rents and royalties.

Only four of these 17 corporations had been organized since 1960. This is in sharp contrast to the 15 operating corporations where 11 had been organized after 1960 and 8 of these were taxed as partnerships.

Four Other Corporations

Some information was received from four other corporations but the questionnaire was not filled out. Hence, they could not be readily compared with the other corporations.

One incorporator writes "my brother and I wished to see that our mother was adequately provided for and we put certain properties in the corporation in order to provide income ... as long as she should live. She was the administrative officer and drew the salary and as a result was wholly independent though the stock in the corporation belonged to my brother and myself. It also provided certain fringe benefits which could not be obtained in any other manner including making her eligible for Social Security."

In a second case the widow of a man who incorporated his ranch and left it for his widow and several children writes, "I'm afraid I couldn't give you a very good opinion on corporations. Our experience has been a very bitter one of family relations." Now "it's being so poorly operated ... it's being sold."

In a third case the incorporator wrote, "I have never activated my corporation. It was started because I had several children that I wanted to work into the business." But because "I sometimes receive more than one half of my income as rents, interest, etc. it might be considered a personal holding corporation and be subject to an exorbitant tax. For that reason I decided not to use it at this time."

A fourth reply merely stated, "This property has been disposed of." In a fifth case the incorporator wrote "The ... corporation is dissolved and everything sold out." No reasons for these actions were given. An executive in a large meat packing corporation wrote to explain that the land held was not intended nor being used for farming.

Four other firms wrote to explain that they were not incorporated. Three were partnerships and a fourth was "just a feed mill."

Summary and Conclusions

Not all questions about corporation farming can be answered by this study. This is true because there is no assurance that the structure of those which replied are comparable to those that did not.

What the survey does reveal is that the persons who replied said that the farm and ranch corporations with which they were associated had the following characteristics:

1. Only 15 of the 41 firms that responded were actually engaged in farming or ranching. Another 17 were leasing land to independent farmers. Of these, 14 were out-of-state (foreign) corporations.

2. Most of the 15 operating corporations were cow-calf ranches consisting of 13,000 acres as an average. In contrast, the 17

landlord or leasing corporations averaged only 5,000 acres each.

3. The 15 operating corporations averaged only 4.5 stockholders. In 13 of the 15 firms all the stockholders were related. About two-thirds of the leasing corporations were also family corporations. Others were a mining firm, a flour firm, a private college, a mission and two smaller firms.

4. Of the 15 operating corporations

   a. Almost all doubted that incorporation made it easier to raise capital.

   b. About half said that incorporating did not make it possible to "efficiently manage much more land and livestock than can an independent farmer or rancher."

   c. Most of them said that had no experience using corporations as a tax shelter. They had no off-farm income taxes to be reduced.

   d. Keeping the farm in the family was the main reason for incorporation.

   e. Most said they would urge a friend to incorporate, especially if there was a large family that wanted to keep the farm intact.

5. The 15 operating corporations were quite young. Only two had been organized prior to 1960. In contrast 13 of the 17 leasing corporations were organized prior to 1960.

6. In the 15 operating corporations, all but two of the managers were stockholders and all but five were related to other stockholders. The 17 corporations that leased their land to farmers did not have operating managers or hired men.

<u>Survey of Farm and Ranch Corporations</u>

Economics Department, South Dakota State University
Brookings, South Dakota, 57006

Name of corporation ______________________________

Address ______________________________

Year incorporated ________ State in which incorporated ____________

1. About how many persons own stock in this corporation? (Circle one)
   1 2 3 4 5 6 7 8 9 10 11-20 21-30 over 30

2. How many of these stockholders related by blood or marriage?
   . . . .(number) ________
   ____
   ____

3. Is your corporation taxed as a partnership? (yes or no)______

4. If your corporation holds farming or grazing lands, how much of these lands are held
   by deed: acres ________
   by lease: acres ________
   by permit: acres ________
   Total: acres ________

5. The way your lands are handled is important. Please indicate the
   acres directly managed ________
   acres rented or leased to others ________
   ____

6. If some of the land is directly managed, is the manager a stockholder in your corporation?. . . . . (yes or no)______
   ____

7. Is the manager of these corporate lands related to any stockholder?
   . . . .(yes or no)______
   ____

8. What are the main livestock and crop enterprises on the directly managed lands? ______________________________
   ____

9. About how many months of labor are used each year on the directly operated land?
Months of manager's labor ________
Months unpaid family labor ________
Months of hired labor ________

10. What were the circumstances that led your corporation to become active in holding and/or operating farm land? ____________________

____

____

____

11. Is your corporation engaged in any non-farm business? (yes or no)____
If "yes" what is this business? ____________________

____

____

In what year was this non-farm business started? Year __________
What share of your corporate net income was from your non-farm business? . . . . .Share __________

12. Some people say that corporations can raise capital more easily and cheaply than can farmers who are not incorporated. What has been your experience? ____________________

____

____

13. Some people say that a corporation can efficiently manage much more land and livestock than can an independent farmer or rancher. What has been your experience? ____________________

____

____

14. Some people say that a non-farm corporations can profitably reduce their income taxes by the purchase of farms or ranches which lose money because of heavy investments in improvements. What has been your experience? ____________________

____

____

15. Some people say that the main advantage of incorporating a farm is that it helps keep the farm in the family by making estate planning easier. How do you feel about this? ______________________________

____

____

16. Under what conditions would you urge a friend to incorporate his farm or ranch? ______________________________

____

____

17. Are you an officer of this corporation?. . . . . . (yes or no)______
If "yes" what office do you hold? ______________________________
What share of the stock do you own? ______________________________

18. Would you like a summary of the findings of this survey? . . . .(yes or no)______

Your name ______________________________

Your address ______________________________

Your phone number ______________________________

Remember your identity will not be revealed. If you have questions please write or phone me. Office phone: 605-692-6111. Evenings: 605-692-6556.

Thank you for your help. Please return this questionnaire in the self-addressed and stamped envelope.

R.L. Berry

1. What's the nature of corporation farms in South Dakota?

HOW MANY FARM and ranch corporations are there in South Dakota?

According to the records of the Secretary of State, there are 227 "domestic" corporations organized whose stated purpose is to "engage in farming" .... "to produce grain and livestock" .... "to engage in ranching" .... "to raise cattle or sheep," or similar statements of intent to farm or ranch.

Excluded are firms engaged in fattening livestock, producing poultry or eggs and raising furbearing animals. Also excluded are real estate firms, professional real estate managers and a few other firms whose purpose is "to engage in any business permitted by law," or other words to this effect. Finally, "foreign" corporations—those organized in other states but authorized to do business in South Dakota—are also excluded because their statements of purpose were not readily available. Judging by names alone, it appears there may be two or three dozen such "foreign" corporations engaged in farming or ranching in South Dakota, in addition to the 227 domestic corporations mentioned above.

These farm corporations make up about .5% of the 50,000 farms and ranches in South Dakota.

The years in which the domestic farm corporations were organized are:

Year	Number
All before 1956	12
1956	3
1957	8
1958	5
1959	7
1960	23
1961	22
1962	26
1963	24
1964	24
1965	26
1966	18
1967	29
Total	227

Perhaps the main reason for the increase in 1960 was a change in the Internal Revenue laws which permitted small, closely-held corporations to be taxed as partnerships rather than corporations. This change in the law permitted such firms to more easily avoid double taxation of income—once as it is received by the corporation and again after it is received by stockholders.

Is this a fair count? The South Dakota Farmers Union has just completed a survey to determine all the land owned by corporations in South Dakota. It found 396 land-owning corporations with South Dakota addresses that owned 1.3 million acres of land. This includes all firms holding agricultural land, whether they operate it directly or lease it to independent farmers and ranchers. Their average size is 3,280 acres.

The Farmers Union also found 56 other corporations with out-of-state addresses that owned 313,000 acres of land—an average of 5,590 acres per corporation. Total farm land held by corporations was 1.6 million acres or 3.6% of the 45 million acres in South Dakota.

How many of these land-owning corporations are family owned and operated? This question is not easily answered, but some clues can be found in the information available from the Secretary of State.

Clues are of three kinds: (1) size of corporation as measured by the amount of authorized capital stock, (2) the number of different family names on the original board of directors and (3) the number of directors with out-of-state addresses.

It seems reasonable to believe that the larger the farm or ranch corporation, the less likely it is to be family owned and operated. So let's look at the 24 largest farm corporations—those authorized to issue over $500,000 of capital stock. Only five of these are authorized to issue over $1 million worth of stock and none exceed $2 million.

Of these 24 firms, only three had directors whose addresses are out-of-state. In two of these three cases, the names indicated the out-of-state directors are members of the same family.

Only three had three or more family names on the original board of directors.

There is no trend evident in the organization of firms authorized to issue over $500,000 worth of capital stock. This is shown in the following figures of numbers organized:

Year	Number
Before 1960	3
1960	4
1961	1
1962	0
1963	4
1964	3
1965	3
1966	2
1967	4
Total	24

Now let's look at the 53 corporations authorized to issue $500,000 of capital stock. The number of family names on the original board of directors includes:

Names	Number	Percent
One only	28	53
Two	19	36
Three	6	11
Four	0	0
Total	53	100

Only one of these 53 firms had one or more directors living in another state (Minnesota) and the family name was the same as that in South Dakota.

This examination of the 77 largest domestic farm and ranch corporations in South Dakota suggests that virtually all are family-owned and operated.

At the moment, similar information is lacking for the 56 foreign corporations that own agricultural land. No doubt some of these lease land to independent farmers and hence are family operated. (The question of whether or not incorporation will destroy family farms will be discussed next)—Russell L. Berry, SDSU.

2. Will incorporation destroy family farms?

WHAT EFFECT, if any, has incorporation of farms had on numbers of farms? . . . size of farms? Very little—judging by the experience in North and South Dakota.

There are no restrictions on farm corporations in South Dakota and there are 250 to 300 such farm corporations in the state. In North Dakota, farm corporations have been prohibited since 1932. Hence it has no farm corporations.

When the number of farms are compared, we find little difference:

	South Dakota	North Dakota
1950	67,000	66,000
1954	64,000	63,000
1959	60,000	57,000
1964	53,000	56,000
1967	50,000	47,000
Change	17,000	19,000

South Dakota lost about 1,000 farms a year, compared to 1,100 for North Dakota. Also, size of farms in acres varied little.

	South Dakota	North Dakota
	Acres	
1950	669	647
1954	711	683
1959	762	740
1964	814	834
1967	898	894
Change	228	247

From 1950 to 1967, South Dakota farms increased in size by 228 acres, while North Dakota farms increased by 247 acres. Thus, North Dakota with its law against corporations lost slightly more farms and its farms grew somewhat more rapidly than in South Dakota, where 250 to 300 farm and ranch corporations are operating.

If the laws remain the same as they are at the present, will this situation continue? The answer probably depends upon another question. Does incorporation enable a farmer to handle more land than an unincorporated farmer? There is not the slightest evidence that incorporation has this effect.

It is true that incorporated farms tend to be considerably larger than the average. But in the few cases we have studied, there is no evidence that incorporation was the cause of the increased size. On the contrary, large farms and large partnerships seem to incorporate, not necessarily to get larger, but to prevent the breaking up of their present farm business. Estate planning or father-son transfer is the important goal.

If this is one goal, what are other important goals of farmers? How might incorporation of their farm affect these goals? These questions are important because some farmers believe incorporation is desirable, while others fear farm corporations will destroy all that is dear to them.

Land ownership appears to be one of the strongest goals of farmers. In a recent Indiana study, 100% of the farmers interviewed said land ownership was one of their goals, despite the fact that many already owned some land. Their desire to own land was matched only by their desire for a high school education for their children (Purdue Agr. Exp. Sta. Res. Bul. 663, 1958).

These results are not particularly surprising. Strength of the farm ownership goal has long been indicated by the early disposal of public lands, and various homestead acts, farm mortgage credit acts, farm foreclosure legislation, legal bars against farm mortgage companies holding land more than ten years in several midwestern states and denial to corporations of the right to engage in farming or ranching in Kansas and North Dakota. In 1965, Kansas adopted a law which permits some family-type corporations to engage in farming. North Dakota will vote in November whether or not to allow farm families to incorporate their farms. Present Minnesota law does not permit corporations to acquire more than 5,000 acres of land.

Farm tenure specialists are agreed that the goal of ownership is strong because it is a means to higher goals which have been called the four F's: fixity of security of tenure, freedom of operation, freedom of improvement and fair land costs or rents. A recent review of 22 articles which discussed farm tenure goals showed all 22 listed fixity or security of tenure as an important goal. Eighteen listed freedom to improve the farm, 17 freedom to operate the farm as they desired, 10 fair or equitable rents and 14 economic efficiency. Some of the farm tenure specialists who put heavy emphasis on efficiency recognized the need for security of tenure to permit freedom to improve and freedom to operate if efficiency is to be achieved.

How does incorporation affect the farmer's four F's?

Usually the farmer considering incorporation owns some land. When he incorporates, he owns the corporation which owns the land. Hence his security as owner is as great as ever. It remains the same until he transfers stock to others. When he sells or gives stock to others, they have some say about the corporation. Hence the farmer's freedom of farming may be somewhat limited by the other stockholders. The same may be true of his freedom to improve the land.

Continued -- p. 16.

But some farmers like to incorporate because it makes it possible to transfer ownership and management to their children or others. These farmers then have freedom from worry about keeping the farm in the family. Thus they may lose some freedom to manage but gain freedom from management.

Short-run, personal security may be sacrificed for long-run family security. Keeping the farm in the family may become more important than keeping the farm —because, after all, the farmer can't take the farm with him when he dies.

Thus, farm incorporation may be more attractive than selling or giving the farm to a son before or after death, or allowing the inheritance laws to make the transfer with the risk that the farm will be divided or sold out of the family.

Farm incorporation may thus be considered a better way of helping a son achieve the four F's. Stock in a corporation can be transferred in smaller amounts than can land. The price can be "fair." Gift taxes can be more easily avoided. Certain other advantages may also be realized. Most of these were discussed by Lawyer Norm Krausz in THE FARMER Jan. 20, 1968, page 17—Russell L. Berry, SDSU.

THE FARMER, March 16, 1968 / 69

3. Why some farmers fear farm corporations

FARMERS WHO HAVE large and successful farms and ranches often look with favor upon farm incorporation. They recognize that incorporation may give them several advantages over sole proprietorship or a partnership.

Here are some of the advantages:

- It helps keep the son interested in the farm.
- It makes it easier to transfer ownership before death.
- Sometimes taxes can be reduced.
- There is limited liability for debts.
- Life of the corporation can be unlimited.
- Management may be improved because two heads may be better than one.
- Fringe benefits such as retirement plans, tax-free medical benefits and group life insurance may be attractive.
- Credit may be somewhat easier to obtain.

But farmers who own little or no land and who are struggling to acquire it may fear farm incorporation. They may feel the advantages listed make it harder for them to compete for land.

They fear loss of the four F's: fixity of tenure, freedom of operation, freedom to improve and fair land charges. They fear farm corporations may reduce them from free and independent farmers to hired hands. They think they foresee the day when much, if not all of agriculture will be in the grips of a factory-type corporation.

Are these fears well-founded? What are the prospects?

There is an element of truth in these fears. As farms become larger, fewer farmers are needed. Hence, young men who would like to farm may find it necessary to seek employment in other occupations. Many have found such employment in factories in the city.

But it should be noted that farm corporations are not to blame for this trend. Since 1935, South Dakota has been losing 1,000 farms a year. Yet South Dakota had fewer than 50 farm corporations in 1960. North Dakota has lost 1,100 farms each year since 1950, even though corporations have not been allowed to own and operate farms in that state.

The rapid increase in farm size and hence the reduction in farm numbers is largely caused by farmer adoption of labor-saving tractors, machinery, insecticides, herbicides and other practices.

If all Dakota farms were reorganized to be as efficient as were the most efficient in 1959, average size would increase 100 to 300%. Numbers of farms would decrease 50 to 80%; capital use would increase 200 to 400% and labor would decrease 20 to 30%, according to a study recently made by Don Kaldor and William Saupe at Iowa State University.

While many of these large farms might find incorporation desirable in the future, incorporation was not the cause of these large efficient farms in 1959. There is no reason to believe that prohibiting farm corporations will have any important effect on this trend in the future—Russell L. Berry, SDSU.

THE FARMER, April 6, 1968 / 65

4. Factory farms: myth or reality?

BECAUSE FRUIT or truck-crop farms often use much hired labor, some farmers fear "factories-in-the-fields" may soon become a reality. They fear they may be reduced to hired hands or replaced by labor from the South, Mexico, or perhaps the Indian reservations.

Chances of such a development are indeed remote. Corn and small grain require much land, much machinery and relatively little labor, but much good management. Production of calves or lambs also requires much land and relatively little labor, but also good management.

Also, the labor required for midwestern farms and ranches must be both willing and able to operate without much, if any, supervision. Because of distances from field to field or range to range, close supervision, as on a truck or fruit farm or a factory, is simply impossible.

How can the manager secure such labor without giving him an interest in the crops or livestock produced? An occasional hired man may be able and willing to farm as carefully as an independent farmer. But such men are scarce and very costly, as every farmer knows. That is why farmers have replaced not only the horse but also the hired man with labor-saving tractors, machinery, herbicides, insecticides, fertilizers, and so on.

This modern machinery permits farm families to operate 1,000-acre farms in the Corn Belt; 2,000-acre farms in the Wheat Belt and 7,000 acres or more in ranching country.

Suppose ten farm families were to be employed by a farm corporation in the Corn Belt. At least 10,000 acres of land would be needed for efficient operation.

Where would the corporation be able to secure this much land in one block? Likely, the land would be scattered all over the county. One man trying to supervise all the work on ten efficient farms would indeed be busy. If the men on each unit were capable of farming without centralized direction, not much would be gained by having the manager. Such a corporation might well be ahead if it leased the land to the operators. There would be little or no saving in labor. Likely, more labor would be needed for supervision and family labor would not be readily available, as it is on family farms.

Also, there probably would be little or no saving in machinery, as compared to the family farm. Each 1,000 acres would require about the same amount of machinery whether farmed by independent farmers or tenants, or farmed together as one 10,000-acre farm. The reason is that critical planting season would occur at the same time on each of these units and it is doubtful that the work could be more efficiently done with ten efficient 1,000-acre units combined into one unit.

If such a 10,000-acre farm were practical and profitable, we would have many more of them than we do today. The lesson learned from the Bonanza Farms of the Red River Valley is that the practicality of such large, factory-type farms is a myth, not a reality—Russell L. Berry, SDSU.

5. Should unsettled farm estates be incorporated?

[E] SOMETIMES INCORPORATION helps avoid an unhappy situation like this one. But it is not a complete cure.

"My father died four years ago. Since then I have been operating the farm on a crop-share basis. Because we inherited undivided shares, I pay rent to my brother and two married sisters. My sisters want to sell but neither I nor my brother want to buy them out. We find it hard to agree upon crops. Also I need to make improvements on the house and other buildings. Would incorporating the farm help solve these problems?"

This situation is not uncommon. There is real need for a solution. Selling the farm is often not desired. It conflicts with the goal of keeping the farm in the family.

Incorporating the farm may be a step in the right direction, but the real problem is one of management. Unfortunately, the family can disagree as a board of directors just as easily as it can under an unsettled estate. Incorporating might eliminate the need to sell the land. Some corporate stock might be sold when money is needed. Ordinarily, a member of the family should have the first opportunity to buy the stock.

The management problem can be eased, if not solved, however. This can be done if the stockholders can agree that the farm should be leased to the operator for a cash rent. If desired, this cash rent can be made to vary with county average yields of the most important crop, such as corn or wheat. Pasture rents may be made to vary with cattle prices. If properly done, this should give the tenant freedom to grow any crops that he pleases. Because there would be less friction over the crops, the tenant should feel more secure. Also the other childern may be more willing to allow the tenant to make improvements and compensate him for their unexhausted value when he leaves the farm. Or they might agree to make the improvements for enough extra rent to cover their costs for depreciation, interest, repairs, taxes and insurance.

Obviously, cash rent is the key to the problem. But incorporation may provide the stability of ownership necessary for good cash leasing. Cash leasing can be done by an unsettled estate, but if some heirs need money the unsettled estate makes a poor landlord. (End of series)—Russell L. Berry, SDSU.

6. Factory farms: more efficient than family farms?

by Russell L. Berry
farm management specialist, SDSU

Religious beliefs keep Hutterite factory-type farms operating

IF FACTORY-TYPE FARMING is more efficient than family farming, then some of the large farms should show evidence of such efficiency. For example, do the 24 Hutterite colonies in central South Dakota present evidence that factory farming is more profitable than family farms?

The Hutterites are a small religious group that originated in central Europe during the Protestant Reformation of the 16th century. One of their strong religious beliefs, based on a literal interpretation of Acts 2:44-45, is that they should hold all land and goods in common and that the practice of communal living is the highest expression of Christian love.

The Hutterites live in small agricultural "villages" or colonies located near the center of their land. At the center of the villages are church, school, communal dining hall and residences. Surrounding this area are maintenance shops, granaries, barns and sheds for livestock and poultry.

The "average" colony has 14 families of seven members each. Each colony has about 5,100 acres of land of which 54% is cropland. All of the land is owned or leased by the colony. All machinery and livestock are also owned in common. Finally, the land is operated in common, using modern track and diesel tractors. The largest can pull plows with as many as nine 14-inch bottoms.

The facts in this article about the Hutterites come from Professor Marvin P. Riley, "The Hutterites: South Dakota's Communal Farmers," S. Dak. Agr. Exp. Sta. Bul. 530. 1966.

Thus, the Hutterite colonies exhibit some of the characteristics of factory farming. They are organized with a business manager and department heads for such enterprises as crops, cattle and poultry. They have several families employed on the farm as "hired hands." While the hands are part owners of the colony and receive no wages as such, the general organization is still quite similar to the type of organization that many people have in mind when they speak of "factory farms." Full use is made of modern labor-saving machinery and there is some specialization of labor use.

If the Hutterite factory farms are more profitable than family farms, then the Hutterites must either be able to secure increased production per acre or reduce costs—or both. There are no reasons to suggest that their yields are higher than those of family type farms. Even if they should be higher, there are no reasons the family farmer cannot use the same practices and secure similar yields. Thus, the advantage, if any, must be in lower costs.

Except possibly for plowing, discing, or similar heavy work, the cost of fuel, oil, grease and repairs is not likely to be any less than for the family type farm. Most of the lighter field work can be handled by two- and three-bottom tractors more efficiently than by larger tractors. Corn planting, seeding, mowing, raking, harrowing, spraying, cultivating and hauling are examples.

Seeds, weed and insect sprays, twine, baling wire, etc., usually cost the same per acre, whether done on a large scale or small.

Any reduction in price due to large scale purchasing can often be matched by the family farmer through cooperative purchasing. So there's little advantage here.

About the only advantage that the Hutterites may have over the family farm is in spreading the high fixed costs of machinery and labor over more acres. As mentioned, some of them use very large tractors and they have large farms: the large tractors could reduce the labor needed. The large acreage would reduce the average fixed costs for depreciation, interest and labor per acre or per bushel. This might make them more profitable than family farms. But are they?

There is no question that large machinery can be efficiently used

Farmer reprint distributed by the South Dakota Agricultural Experiment Station, South Dakota State College, Brookings, S. D.

on the large acreage farmed. But the adoption of the labor-saving machinery may have created considerable under-employment in each colony. Or, the labor may be used on less profitable enterprises, thus resulting in overall inefficiency.

Unfortunately information is not available for a complete analysis. However, there is information that suggests that the Hutterite's "factory system" is less efficient than is the family system in that same region.

For example, the average acreage per Hutterite family is only 360 acres, or about a half-section. Of this amount, only 200 acres are in cropland. Most of these colonies are located in either the South James or the North James River areas, hence it is helpful to compare the average acreage per Hutterite family with the averages for all farmers in the area. In 1959, the average farm in the South James area had 364 acres, while the North James area farms average 579 acres. There is nothing to suggest that the colonies are more efficient. This is especially true when it is remembered that the "average farm" for these areas contains many "horse and buggy" farms which have not yet been adjusted to the capacity of the modern tractor and its equipment. A recent study indicates that if all farms were reorganized as efficiently as the most efficient family farms were in 1959, that farms in eastern South Dakota would average about 1,000 acres while those in central South Dakota about 2,000 acres.

In short, it appears that 5 of the 14 families could easily handle the cropland of the average colony if the land were operated as several family farms, rather than as one unit. This would be about 1,000 acres per family with 540 acres of cropland. In view of the fact that his land is in the edge of the small grain country rather than the Corn Belt, little difficulty should be had in farming this acreage. The cattle or sheep necessary to utilize the pasture and the rough feeds produced as a by-product of grain could also be easily handled by the family when members were not busy with crop work. Some of the grain produced could be fed to calves, lambs, hogs, or poultry. Both machinery and labor would be efficiently employed throughout the year.

If this analysis is correct, each colony has at least 9 families for whom additional work must be found. Some of these may be employed in intensive dairy, hog or poultry enterprises. Some may be employed as managers, bookkeepers, mechanics, storekeepers, butchers, shoemakers and broom makers. But there is room for considerable doubt that these persons are fully or efficiently employed. Most storekeepers in town serve many more than 14 families. The employment and support of all these families must be a considerable burden on the colony unless they are more fully employed than the available information suggests.

At this point it may be objected that this analysis merely indicates that the colonies are not efficiently managed because they cannot "fire" the excess labor not needed for the amount of farm land that they have been able to accumulate. This is true. But suppose each of the 14 families had 1,000 acres with sufficient livestock to keep them busy as outlined above. What, if any, advantages can be found for suggesting that they farm together as one large factory farm? Specialization might be one advantage. The seasonal nature of both crop and livestock production, however, might be expected to make this "advantage" a costly one. The manager may find it difficult to get the specialized workers to take on other tasks during the slack seasons. The "hired" workers would lack the profit incentive and hence would not work as hard as they would if they were farming for themselves. Management itself might require the full time of two or three men. Their "wages" become a cost to the producing units of the colony or factory farm. Thus, even if each Hutterite family had as much land as most independent farmers, there seems to be no reason to think they would be more efficient because they use the factory system.

None of the Hutterite colonies have been known to fail despite the fact there appear to be some reasons to think that they are inherently less efficient than family farms. This being true, could not other factory farms succeed? No doubt they could if they had the Hutterites strong religious conviction that communal living is God's command. As a result of their strong religious belief they are willing to accept a low return for their labor and management. They deny themselves many of the comforts and pleasures that most farmers would consider necessities.

Thus, the analysis of the experience of the Hutterite colonies does not support the notion that factory-type farms are likely to banish the family farm as the tractor banished the horse. Agricultural production is a biological process closely tied to the seasons. Farm families must work hard for very long hours at certain times of the year and have little productive work to do at other times. Weather and the limited growing season seem to make it impossible to organize a factory farm that can compete with the independent farmer.

7. Will a farm or ranch corporation reduce taxes?

by Russell L. Berry
South Dakota State University
Farm Management Specialist

CAN FARMERS and ranchers reduce their Federal income taxes by incorporating? The answer is "no" for most farmers. Only the few farmers with taxable incomes of $20,000 or more are likely to be able to reduce their income tax. The answer is also "no" for farm corporations that qualify and request to be exempted from the corporation tax under Subchapter S of the Internal Revenue Code adopted in 1958. The reason is that all income is distributed to the owners. Hence, the rates are the same as for the sole proprietorship or salaried person.

How can farmers with $20,000 or more taxable income reduce their tax by incorporating? The answer lies in the different rates charged. For regular corporations, the tax rate is 22% on the first $25,000 and 48% for all income above $25,000.

In contrast, individuals, sole proprietors and partnerships are all taxed at the same rates—varying from 14 to 70%—depending upon income made and whether separate or joint returns are filed.

As is shown in the table, taxable income up to $20,000 for a farmer filing a joint return with his wife would be lower than the corporate rate of 22% (see col. 3).

If the farmer is incorporated, the tax can be kept at less than 22% by simply paying the taxable income as "reasonable" salaries to himself and wife (col. 4). Thus, the tax would be the same as for the sole proprietor up to $20,000 of taxable income (compare cols. 2 and 6). But if the salaries do not appear to be reasonable, the excess will be taxed.

If taxable income was $24,000, the individual rate of 23% is higher than the corporate rate of 22%. To avoid the 23% rate, $4,000 should be retained in the corporation and taxed at 22%. The resulting tax saving is $400 (compare col. 2 and col. 8).

The same reasoning applies when the taxable income is $32,000. The tax saving in this case is $1,640. However, few farms make $32,000 or more. Hence, few can make this saving.

If the farm income is $52,000, the same system applies, but the $32,000 retained exceeds $25,000 and hence the excess is taxed at the corporate rate of 48%. Even so, there is a tax saving of $4,820 for the rare farm or ranch with this much income.

But there is a limit to tax saving possibilities. When the farm corporation retains $30,000 or more, some of this may be paid as dividends and the farmer and his wife will then be subject to double taxation—once at the corporation rates and then again as personal income when the dividends are received. This may make the total tax higher than for the unincorporated farmer.

Also, if "too much" is retained there is a 27.5% penalty tax on the first $100,000 improperly retained and 38.5% on all over that amount. Usually no questions are raised about the first $100,000 retained by city corporations. Farm corporations may be another matter.

The lesson from all this is that, for almost all farmers, incorporating will not reduce Federal income taxes. In fact, their income will be subject to double taxation unless it is paid out as salaries or unless they qualify and have elected to be taxed as a Subchapter S corporation. The latter does not reduce income taxes, since stockholders are taxed at the personal rate on all income received. Hence, most farmers need other reasons than possible Federal income tax savings for incorporating their farm or ranch.

Other taxes

State income taxes treat corporations as a separate taxpayer, but the details vary. South Dakota does not have a corporate income tax. North Dakota, Minnesota, Nebraska, Iowa and Kansas do.

Federal death and gift taxes are the same whether the farm is incorporated or not. However, because it is easier to transfer stock than land, it is easier to make gifts which reduce death taxes. For example, Federal tax laws allow a person to make $3,000 in outright gifts to each of his children or other beneficiaries each year without tax. Hence, if this seems desirable, incorporation of the farm may help reduce taxes.

None of the 13 states in the North Central Region tax outright gifts at death unless they are made in contemplation of death. In this region, only Minnesota and Wisconsin have gift taxes.

Farm corporations are subject to real and personal property taxes. Since in most states the stock held by a shareholder is also considered as personal property, double taxation may result. However, the stock of most firms incorporated in South Dakota is not taxed. Some other states provide an "offset" to avoid double taxation.

Farm corporations must pay a social security tax of 4.4% on the wages of each employee up to $6,600 a year. They must withhold another 4.4% from the employees

Comparison of farmer's taxes (filing joint return) as sole proprietor and incorporated business, 1967.

	Taxes as sole proprietor		Taxes under corporate form of business: When taxable income is:		Amount of taxes is:		
Taxable income*	amount	rate**	Paid as salaries*	Retained in corp.	on salaries	on corp.	Total tax
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$ 4,000	$ 620	16%	$ 4,000	$ ...	$ 620	$ ...	$ 620
8,000	1,380	17%	8,000	...	1,380	...	1,380
12,000	2,260	19%	12,000	...	2,260	...	2,260
16,000	3,260	20%	16,000	...	3,260	...	3,260
20,000	4,380	22%	20,000	...	4,380	...	4,380
24,000	5,660	23%	20,000	4,000	4,380	880	5,260
32,000	8,660	27%	20,000	12,000	4,380	2,640	7,020
52,000	18,060	35%	20,000	32,000	4,380	8,860	13,240

* After allowable personal exemptions and standard deductions.

** Calculated by dividing amount (col. 2) by taxable income (col. 1).

wage. In contrast, a self-employed individual pays 6.4% on $6,600 of his income.

Because of the complexity created by two sets of tax laws—one for the individual and another for the corporation—anyone planning to incorporate a farm or ranch should get expert tax advice not only before incorporating but continuously to prevent unnecessary taxes and tax problems. End.

8. Farm tax law changes may not benefit you

FARMERS COULD LOSE two important tax advantages in their struggle to keep city people with high personal incomes from using "farm losses" to reduce their Federal income taxes. These advantages are the cash method of reporting income for tax purposes and their right to charge off some capital costs as they occur without reporting increases in value.

Senator Lee Metcalf (D-Montana) and Senator Jack Miller (R-Iowa) have introduced separate bills, both of which declare that "deductions attributable to the business of farming" by city investors or city corporations "shall not exceed an aggregate amount equal to the gross income derived from the business of farming for the taxable year."

In comment on the Metcalf bill, the Treasury Department has pointed out that farmers have been allowed to use the cash method of tax reporting to simplify their bookkeeping (Congressional Record—Senate, July 17, 1968). Under this plan, income is reported when received as cash and costs when paid in cash (or equivalents). Inventories are ignored. Also "farmers have been permitted to deduct some admittedly capital costs as they are incurred."

A city investor in a high tax bracket may use these special rules for farmers to make large tax savings. To do this, the investor may develop citrus groves, fruit orchards and vineyards, or raise livestock for breeding.

"For example, a citrus grove may not bear a commercial crop until six or seven years after it has been planted. Yet the farmer may elect to deduct, as incurred, all costs of raising the grove," the Treasury Department said.

Similarly, the expenses of raising livestock for breeding purposes may also be deducted currently. Included are breeding fees, costs of feed and other bona fide expenses of growing the herd.

Because little or no income is produced during the development of the citrus grove or breeding stock, artificial "tax losses" may be incurred if the rest of the farm is not very profitable, even though in the long run there are substantial profits. These "tax losses" may then be deducted from the city investor's high-bracket income. This may result in large tax savings.

If the grove or livestock are sold, any gains will be taxed at the low capital gains rate of 25%.

An example will make clear how the tax saving results. Suppose the cost of raising a breeding herd produces a "farm loss" of $8,000. Then a city investor with personal income of $40,000 and top tax rate of 45% could use his "farm loss" to reduce his taxable income to $32,000, where the top rate is 39%. This would reduce his personal tax from $12,140 to $8,660—a tax saving of $3,480 (see 1967 rates for married couples).

Also, if the herd is sold, there would be a capital gain tax of only 25% on the entire sale price.

For investors with higher incomes than $40,000, the tax savings would be greater. But in 1964 there were only 196,000 taxpayers (0.3%) with gross incomes of $50,000 or more. (Statistics of Income 1964, Internal Revenue Service Publication 198, Table 1). Probably less than 5% of these taxpayers would be interested in farm investments for tax savings.

Like the city investor, the city or industrial corporation can also invest in farm improvements to good advantage—especially if its tax rate is 48% and "farm losses" reduce the rate to 22%. But even if the 48% rate is not changed, farm investments can be profitable. For example, a $10,000 "loss" on a farm would save $4,800 of taxes even if there were no capital gains taxed at 25%.

The Metcalf bill would deny corporations the right to offset non-farm income with farm losses unless 80% or more of the stock is held by bona fide farmers. The Treasury Department pointed out two things: First, this would discriminate on the basis of ownership rather than tax practices. Second, this would merely discourage city corporations from owning unprofitable farms—not profitable ones. Therefore, they suggested that city corporations be treated the same as city owners as discussed.

While Senator Miller's bill was not discussed by the Treasury Department, it is clear that the suggestions also apply to it and for much the same reasons.

A key difficulty of both bills is that of defining farmers and non-farmers. The Treasury Department suggested that the difficulty of defining "bona fide farmer" in Senator Metcalf's bill could be avoided by merely "placing a ceiling on the amount of non-farm income which could be offset by farm losses in any one year."

This limited deduction would protect small part-time farmers or farmers who accept a city job during a poor crop year. They also suggest that excess farm losses could be carried backward or forward to offset farm income, but no other income, of other years. Thus, mainly non-farmers with high personal incomes would be affected.

Changes in Federal tax laws may be desirable to prevent city investors from using farm and ranch losses to reduce their personal income taxes. Yet a recent study of cattle ranches in Arizona by agricultural economists William E. Martin and Jimmie Gotz indicate that it is not at all easy for a city owner of a farm to convert personal taxable income into capital gains taxed at 25%. To make large tax savings, the new improvements must make a large increase in the value of the farm. At the same time, the farm must lose money (but not too much) if a tax shelter is to be achieved.

In any event, the Treasury Department's proposal meets with Senator Metcalf's approval. "I have asked the legislative council's office to incorporate these modifications in a new bill which I plan to introduce as soon as it is ready," he says.—Russell L. Berry

South Dakota Legislative Research Council's study of number and size of farm and ranch corporations, South Dakota, 1968.

	Farms and ranches		Land in farms and ranches		Ave. size of farm or ranch
	Number	Percent	1,000 acres	Percent	Acres
All farms and ranches[a]	47,500	100.0	45,500	100.0	958
Non-corporate[b]	47,163	99.3	44,300	97.4	939
Corporations, total[c]	337	0.7	1,198	2.6	3,560
Domistic, bus.	216	0.4	814	1.8	3,768
Foreign, bus.	31	0.1	143	0.3	4,613
Other corp.[d]	90	0.2	241	0.5	2,677

[a] South Dakota Crop and Livestock Reporting Service, South Dakota Agriculture, 1968, p. 63.

[b] Non-corporate includes individual proprietorships and partnerships.

[c] Staff Memorandum, "Corporate Ownership of Agricultural Land and Farming," South Dakota State Legislative Research Council, Pierre, S. D., August 15, 1968, p. 14.

[d] Includes 78 non-stock and 12 cooperative corporations. Of these 90 corporations 73 are grazing associations, 10 are Hutterite Colonies, and 7 are camps or other.

SOME ADDITIONAL READINGS

A copy of these publications may be secured free of charge by writing to Bulletin Room, South Dakota State University, Brookings, South Dakota, 57006.

1. The Farm Corporation, North Central Regional Publication II, Iowa State Extension Service Pm-273 Rev. 1967. This pamphlet tells what a farm corporation is, how it works and how it is taxed. Gives some advantages and disadvantages.

2. Corporations Having Agricultural Operations -- A Preliminary Report, Economic Research Service, U.S. Department of Agriculture, Agr. Econ. Report 142, August, 1968. This report presents figures showing the number, kinds and general characteristics of farm corporations in 22 central and western states as reported by county ASCS offices with help from other Federal agencies.

3. Corporate Ownership of Agricultural Land and Farming, S.D. State Legislative Research Council, Staff Memorandum, State Capitol, Pierre, South Dakota, August 13, 1968. This memo reviews the situation in Kansas, Minnesota, North Dakota and Oklahoma. It also compares agricultural trends in North Dakota that has prohibited farm corporations since 1932 and South Dakota where farm corporations have been allowed. (also available from Legislative Research Council, Capitol Building, Pierre.)